

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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to: Paul Scranton, Interest Analyst  
Appeals (Tax Policy and Procedure)

from: Blaise G. Dusenberry  
Senior Technician Reviewer  
(Procedure & Administration)



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subject: Complex interest issue for non docketed case

This memorandum responds to your request for assistance concerning how to compute overpayment interest on the net amount of overpayments and an underpayment for multiple years when the period to assess the underpayment expires prior to the consideration by Appeals and the execution of a settlement agreement. For ease of discussion, assume the facts as detailed below. This advice may not be used or cited as precedent.

**ISSUES**

- (1) Can the net amount for 1998 in the example below be assessed allowing the interest due the taxpayer to be computed from the due date of the 1999 return, the NOL generating year (3/15/2000), instead of the filing date for the 1998 taxable year (3/15/1999)?
- (2) In order to accomplish this, how should the settlement computation be shown on Form 2285?

**CONCLUSIONS**

- (1) There is no legal authority to compute interest on a net adjustment to multiple tax years. Therefore, neither computational suggestion is legally valid. Interest must be computed separately for each tax year per the rules provided under section 6601 or section 6611 of the Internal Revenue Code, as appropriate.

- (2) Since the Government may not combine multiple years' underpayments and overpayments to arrive at a net result for interest computational purposes, the second question is moot.

### FACTS

As a result of a multiple year examination, the taxpayer and the Service execute a Form 870-AD, reflecting the following:

1998 tax decrease	<150x>	
1999 tax increase	300x	
2000	no change	
2001 tax decrease	<165x>	
Net change		<15x>

The 1998 tax decrease is intended to be shown as a general adjustment on Form 2285. The Appeals' Officer intends to reflect the net adjustment for all four years on the taxpayer's transcript of accounts for 1998 using Transaction Code 301, effective as of the date of the settlement agreement. As a condition of the settlement, an NOL carryback to 1998 from 1999 is adjusted. The period to assess the 1999 underpayment expired three years before the matter was considered by Appeals.

We understand that the only reason that the Appeals Officer wants to net multiple years' underpayment and overpayments is that the period to assess the 1999 underpayment would have expired years before Appeals considered the matter. There is no indication that the government is attempting to exercise its right to setoff under Lewis v. Reynolds, 284 US 281 (1932), or section 6402(a). This appears to be a case of attempting to circumvent the expiration of the period of limitation on assessment for a tax period in a multi-year audit for which a consent was not obtained.<sup>1</sup>

### LAW AND ANALYSIS

Section 6501(a) states generally that, except as otherwise provided, the amount of any tax imposed by title 26 shall be assessed within 3 years after the return was filed. Section 6501(c)(4) permits the Service and a taxpayer to consent in writing to the extension of the period to assess but the consent must be made before the expiration of the period of limitation.

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<sup>1</sup> It is unclear to us why an Appeals officer might even consider tax year 1999 (using the above example) if the period to assess had already expired years before Appeals considered the matter. If the government were conducting a multi-year examination, the appropriate requests for extension should have been obtained. Note further, that there is no suggestion that the period to assess the 1999 underpayment was open when Appeals took jurisdiction over the other years. Nor is there anything in the facts presented that implicates the application of the mitigation provisions (sections 1311 –1314), or any claim of right, the question of the proper timing of deductions or inclusions in income, any equitable estoppel argument, or any other theory holding the period of limitation open. Consequently, we are not discussing these alternatives.

Section 6601 provides generally that interest on an underpayment will be due from the due date of the underpayment until the date paid. Under section 6611, interest on an overpayment will generally be paid from the date of the overpayment until refunded or credited.

While acknowledging the authority of Appeals to settle tax matters and the independence of Appeals, netting multiple years' overpayments and underpayments in the manner suggested is not legally supportable. The fact that the taxpayer appears to have consented to the action by its execution of Form 870-AD, Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment, does not change our conclusion.

It is axiomatic that income is taxed on an annual basis and each taxable period carries with it its own period of limitation on assessment. See Burnet v. Sanford & Brooks Co., 282 U.S. 359 (1930) (Income must be computed upon an annual basis and the tax liability of each year must be determined with reference to the receipts and expenditures of that year.) Both taxpayers and the Service are required to respect periods of limitation as provided by the Code.

A period of limitation is an indispensable element of fairness as well as of practical administration of income tax policy. See Rothensies v. Electric Storage Battery Co., 329 US 296 (1946). In the field of taxation, periods of limitation sometimes inure to the benefit of the Government, and at other times they work to the taxpayer's advantage. Both hardships to the taxpayers and losses to the revenues may occur. Id.

Interest is also computed on an annual basis. Underpayment interest accrues on the correct tax due for the year, whether reflected on a return or later adjusted by an examination. Overpayment interest accrues on the total overpayment by a taxpayer; again without regard to what was reported on a return or claimed by a taxpayer as a refund.

There are special interest rules that apply when an overpayment by a taxpayer is used to satisfy a liability. See section 6601(f). There are other interest rules that apply when a deficiency is eliminated by the carryback of a NOL. See section 6601(d). There are even interest rules that apply to eliminate the differential interest rates on simultaneous overpayments and underpayments of tax that occur for the same taxpayer on equivalent amounts. See section 6621(d). There are no rules, however, to permit the computation of interest on the net effect of multiple years.

Form 870-AD is the general purpose form that the IRS uses to register and memorialize settlement negotiations. There is language on Form 870-AD purporting to preclude the filing of refund claims. It is, however, not binding in and of itself. See Elbo Coals, Inc. v. United States, 763 F.2d 818 (6th Cir. 1985). In any event, the Form 870-AD was executed well-after the period to assess the 1999 underpayment had expired. Therefore, it could not be found to constitute the written component of an extension of time to assess as agreed to by the taxpayer and the Service.

In summary, the government's failure to obtain a proper consent to extend the period of limitation may not be accomplished by netting multiple years' overpayments and underpayments in the manner suggested. Therefore, neither computational suggestion as to how resulting overpayment interest may be computed, is correct.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Nothing prevents the taxpayer from going to court to enforce the overpayments to which both parties agreed for tax years 1998 and 2001 (in the above example) and then raising the argument that the assessment with respect to tax year 1999 is barred. A Form 870-AD is not a closing agreement and cannot bind the taxpayers with finality. Where a taxpayer takes action contrary to the agreed terms of a previously executed Form 870-AD, the Service's only recourse is to assert that, due to additional factors, the taxpayer should be estopped from doing so.

Some federal courts have found that a Form 870-AD can equitably estop a taxpayer from claiming a refund. Aronsohn v. Commissioner, 988 F.2d 454, 456-57 (3d Cir. 1993); Elbo Coals; Stair v. United States, 516 F.2d 560, 564-65 (2d Cir. 1975); General Split Corp. v. United States, 500 F.2d 998, 1003-04 (7th Cir. 1974); Cain v. United States, 255 F.2d 193, 199 (8th Cir. 1958); Daugette v. Patterson, 250 F.2d 753, 756 (5th Cir. 1957). In these cases, the courts have generally found that there was some form of misrepresentation by the taxpayer in claiming a refund based on an issue that was resolved in the Form 870-AD. Given that the period to assess had expired several years before Appeals considered the matter, it is unlikely the government would prevail on these facts.

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Please call 202-622-4910 if you have any further questions.